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The Bylaw Puzzle in Delaware Corporate Law

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In less than a decade, Delaware's legislature has overruled its courts and reshaped Delaware corporate law on two different occasions: with proxy access bylaws in 2009 and with shareholder litigation bylaws in 2015. Having two dramatic interventions in quick succession would be puzzling under any circumstances. The interventions are even more puzzling because with proxy access, Delaware's legislature authorized the use of bylaws or charter provisions that Delaware's courts had banned, and with shareholder litigation, it banned bylaws or charter provisions that the courts had authorized. This article attempts to unravel the puzzle.

Starting with corporate law doctrine, I find that a doctrinal account has more explanatory power than one might initially expect. In particular, Delaware's courts appear to be zealous in protecting the discretion of corporate managers and directors, whereas the legislature on each occasion intervened to revitalize shareholder protections. But this distinction leaves a variety of questions unanswered, such as the rapidity of the legislature's response and its use of a default rule with proxy access, as compared to a mandatory shareholder litigation rule. To more fully explain the interventions, we need to consider several other factors, including the importance of protecting the credibility of Delaware's judges. The credibility concern suggests that legislative thunderbolts are unlikely to become routine because routine legislative intervention would undercut the authority of Delaware's judiciary.

INTRODUCTION

Delaware's status as the leading state of incorporation for publicly held corporations is so well established that the four-decade debate over charter competition—that is, states' efforts to attract publicly held corporations—is widely thought to be settled. According to the standard cliché, well known to the students of most corporations classes, charter competition is over, and Delaware has won.[1]

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1. *See, e.g.*, Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002) (asserting that Delaware enjoys monopoly status and exploring the implications of Delaware's market power).

Delaware does indeed have a dominant position in corporate law. Roughly 60 percent of the largest corporations are incorporated in Delaware, and more than 80 percent of corporations that choose a state of incorporation outside their home state choose Delaware.[2] Yet Delaware's preeminence does not mean that its law is static or that the state is insulated from outside challenges. The past fifteen years have brought two unexpected jolts to the corporate ecosystem, each of which has prompted surprising shifts in Delaware corporate law.

The first is a marked expansion of federal regulation of corporate law and an accompanying shrinkage of the portion of corporate law that is regulated by Delaware and other states. Since the 1930s, when Congress enacted the Securities Act of 1933[3] and the Securities Exchange Act of 1934,[4] corporate law, which, traditionally was regulated almost entirely by the states, has included an overlay of federal securities law. After a long period of relative quiescence, Congress has sharply expanded the federal component of corporate regulation on two different occasions in the new century. In 2002, Congress enacted the Sarbanes-Oxley Act, which, among other things, banned loans to corporate directors and officers and imposed new internal controls requirements.[5] After the 2008 financial crisis, Congress further federalized state corporate law with the Dodd-Frank Act.[6] The Dodd-Frank Act imposed a new "say on pay" voting requirement[7] and, of particular note for this article, authorized the Securities and Exchange Commission ("SEC") to promulgate rules providing for proxy access—that is, rules that give shareholders the right to include their nominations for the board of directors in the company's own proxy materials.[8]

The second shift is even more recent. In the past decade, the shareholders of Delaware corporations have brought an increasing number and percentage of their lawsuits against corporate directors or officers in states other than Delaware. According to one prominent study, Delaware's share of corporate litigation was 60 percent through 2001, but dropped to 40 percent or less from 2002 on.[9] Sometimes shareholders forsake Delaware altogether. More often, one group of shareholders files a lawsuit in Delaware, whereas others file lawsuits in other states based on the same alleged misconduct, a phenomenon that has become

2. *See, e.g.*, Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 Yale L.J. 553, 567–68, 578 tbls. 2, 5 (2002).

3. Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77a–77aa (2012 & Supp. 2016)).

4. Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a–78kk (2012 & Supp. 2016)).

5. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of the U.S.C.) [hereinafter Sarbanes-Oxley Act]; *id.* § 402, 116 Stat. at 787–88 (codified as amended at 15 U.S.C. § 78m (2012 & Supp. III 2015)) (ban on loans); *id.* § 404, 116 Stat. at 789 (codified as amended at 15 U.S.C. § 7262 (2012)) (internal controls).

6. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of the U.S.C.) [hereinafter Dodd-Frank Act].

7. *Id.* § 951, 124 Stat. at 1899 (codified as amended at 15 U.S.C. § 78n-1 (2012)).

8. *Id.* § 971, 124 Stat. at 1915 (codified as amended at 15 U.S.C. § 78n (2012)).

9. John Armour, Bernard S. Black & Brian R. Cheffins, *Is Delaware Losing Its Cases?*, 9 J. Empirical Legal Stud. 605, 621 (2012).

known as multi-forum litigation. Multi-forum cases require judges to coordinate with their peers elsewhere to determine, among other things, whether and where to consolidate the cases.

Each development made its way to Delaware in the same curious way: as a controversy over the kinds of bylaw provisions a corporation can include in its foundational documents.[10] Between the first and second congressional intervention, shareholders of a Delaware corporation sought to adopt a bylaw that would require the corporation to reimburse the expenses of shareholders who had successfully placed their nominees on the board of directors.[11] During the more recent tussle over multi-forum litigation, firms started adopting clauses that were designed to restrict shareholder litigation by requiring that lawsuits be filed in a particular state—such as Delaware—or by imposing a "loser pays" rule for attorney's fees, which would reverse the usual American rule that plaintiffs are never required to pay the defendant's attorney's fees.[12]

It is curious but perhaps unsurprising that corporate bylaws emerged as the key battleground in Delaware. Although bylaws did not figure prominently in corporate governance battles until recently,[13] Delaware seems to give the parties broad flexibility to adopt bylaws on nearly any subject they wish. Under Delaware's corporate law statute, "[t]he bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees."[14] Given this flexibility, bylaw innovations were an obvious way for parties affected by the two major corporate law developments of the past decade to take advantage of, or defend against, the changing corporate landscape.[15]

Although the centrality of bylaws was perhaps to be expected, Delaware's response to the handling of the controversies that ensued was far more surprising.

10. A corporation's bylaws are its general operating rules. They often include provisions such as the rules for calling a special meeting or the number of directors on the corporation's board. A corporation also can put any of these provisions, including those discussed in this article, in its certificate of incorporation ("charter") if both the directors and the shareholders approve the new charter provision.

11. These developments are described in detail in *infra* Part I.

12. These developments are described in detail in *infra* Part I. A smaller number of corporations adopted arbitration clauses that require shareholders to arbitrate any complaints, rather than litigating in court.

13. Shareholders began invoking their right to amend the corporation's bylaws in proxy contests waged in the late 1980s. *See, e.g.*, Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988). In the 1990s, shareholder activists devised and sought shareholder approval of bylaws that would require shareholder approval before directors could put a poison-pill takeover defense in place. Although the Delaware courts never explicitly ruled on the question of whether poison-pill bylaws are permissible bylaws, a number of leading Delaware commentators concluded that they are not. *See, e.g.*, Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 Tul. L. Rev. 409 (1998) (arguing that the bylaws impermissibly interfere with directorial discretion). The battle over these poison-pill bylaws foreshadowed the controversies I discuss in this article.

14. Del. Code Ann. tit. 8, § 109(b) (2015).

15. Jill Fisch calls these and related developments "the new governance." Jill E. Fisch, *The New Governance*, 81 Brook. L. Rev. (forthcoming 2016) (Pomerantz Lecture).

The Delaware courts struck down the first set of bylaws—proxy access[16]—but upheld the second—shareholder litigation.[17] This divergence of outcomes is mildly puzzling by itself, but the outcomes get even more puzzling when we consider the response of Delaware lawmakers. The Delaware legislature overruled its courts each time. Whereas Delaware's courts struck down the proxy access bylaws and upheld restrictions on shareholder litigation, the Delaware legislature did precisely the opposite, authorizing proxy access[18] and clamping down on shareholder litigation bylaws.[19]

My objective in this article is to try to make sense of these two puzzles: the small puzzle of the Delaware courts' divergent treatment of the two sets of bylaws and the larger puzzle of the Delaware legislature's decision to promptly overrule its courts in both contexts.

The effort to explain Delaware's handling of the bylaw issues will lead me to two issues that have largely been neglected by the existing literature on charter competition and Delaware's status as the preeminent state of incorporation. The first is the credibility of Delaware's judges—and more to the point, potential threats to the credibility of Delaware's judiciary. Second is the question of when and why Delaware's legislature intervenes to redirect the course of Delaware corporate law, rather than leaving its development to the common law process. I believe that these factors are an increasingly important part of the Delaware corporate law story.

Part I of the article describes the two sets of bylaws and the response to each by the Delaware courts and lawmakers in more detail. Part II considers a doctrinal account of the courts' and legislature's actions. Although the doctrinal analysis is more helpful than one might initially expect, it only partially explains the divergent responses of Delaware's courts and legislature. This suggests that additional imperatives may have played a role. Parts III and IV incorporate judicial credibility into a public-choice explanation of the imperatives, such as Delaware's interest in minimizing federal intrusion in state corporate law, which may have influenced the Delaware legislature. Part V introduces and offers initial thoughts on the question of when Delaware's legislature is likely to redirect the course of Delaware corporate law, as it did with both sets of bylaws.

I. A Tale of Two (Sets of) Bylaws

The two most dramatic corporate law changes of the past fifteen years have been the increasing federal role in corporate law and the advent of multi-forum litigation. Delaware's principal role in each context has been to determine

16. *See* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 229 (Del. 2008) (finding that a proxy access bylaw was invalid).

17. *See* ATP Tours, Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014) (finding that a loser-pays bylaw was permissible).

18. *See infra* note 41 and accompanying text.

19. *See infra* notes 54–60 and accompanying text.

whether bylaws relating to the issue in question are permissible under Delaware law.

The capacity to alter a corporation's operating rules by amending or adding a bylaw has been one of the key powers of corporate directors for the past century.[20] Like directors, shareholders have the power to unilaterally alter the bylaws[21]—it is one of the few direct powers shareholders have—and in the past several decades, shareholders have increasingly made use of their authority. Bylaw-based strategies appear to have been an innovation borne of necessity. Delaware's validation of poison-pill takeover defenses in the mid-1980s,[22] together with its case law on the fiduciary duties of target directors, made it difficult for bidders to make bids for target corporations whose directors were resistant to the acquisition.[23] As an alternative, bidders began waging proxy contests designed to replace a majority of the target board with directors more sympathetic to the bidder.[24] Bylaw amendments were a key feature of many of these contests. The bidder might propose to increase the size of the corporation's board, for instance, and to fill the new slots with bidder-friendly directors.[25] When a new issue arises, bylaws are now an obvious place for both directors and shareholders to look for a potential solution.

The discussion that follows provides a brief overview of the two recent disruptions of state corporate law and of Delaware's handling of the bylaw battles that arose in each context.

A. The Advent of Proxy Access Bylaws

In 2002, Congress hastily enacted the Sarbanes-Oxley Act in response to the corporate scandals of 2001–2002.[26] The Sarbanes-Oxley Act added a variety of corporate governance rules to the securities laws, including a requirement

20. Del. Code Ann. tit. 8, § 109(a) (2015). Section 109(a) does not directly authorize directors to alter the corporation's bylaws. Rather, it permits the corporation to provide such authority in its certificate of incorporation. The certificates of publicly held corporations almost always give directors this power. Interestingly, directors originally did not have bylaw authority—only shareholders did. The states' decision to give directors this power was initially controversial in some circles. *See* Hamermesh, *supra* note 13, at 450 (citing a 1908 critique by Arthur Machen, a leading corporate law authority of the time).

21. Del. Code Ann. tit. 8, § 109(a). Whereas directors only have bylaw authority if the certificate provides for it, section 109(a) directly authorizes shareholders to amend the bylaws and forbids the corporation from taking this authority away.

22. Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

23. *See, e.g.*, Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989).

24. The story of bidders' shift from tender offers to proxy contests has often been told. *See, e.g.*, Carmody v. Toll Bros., Inc., 723 A.2d 1180 (Del. Ch. 1998) (discussing the advent of "dead hand" poison pills as a strategy for thwarting proxy contests and invalidating the dead hand pill in that case).

25. Examples of this strategy, and of directors' use of their own bylaw changes to try to thwart shareholder action, include the following: Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988) (adopting heightened scrutiny of actions designed to interfere with shareholder voting); Liquid Audio v. MM Co., 813 A.2d 1118 (Del. 2003) (adopting and reshaping *Blasius* standard).

26. *See supra* note 5.

that publicly held corporations create an audit committee consisting entirely of independent directors, a prohibition on loans to managers and directors, and a requirement that the firm establish a system of internal controls.[27] However, the Sarbanes-Oxley Act did not address the question of whether shareholders should be permitted to include their nominees in the company's proxy materials. Proxy access quickly emerged as the central corporate governance issue of the immediate post-crisis period—the principal piece of unfinished business.[28] The leading advocates for proxy reform included several prominent public pension funds and a variety of other shareholder groups.[29] The Business Roundtable and other manager-oriented groups resisted, insisting that proxy access would unnecessarily complicate the proxy process and would be used to strengthen the leverage of unions rather than to enhance corporate governance.[30] Somewhat surprisingly, perhaps due to fading memories of the earlier scandals, the critics prevailed at the SEC. The SEC left the proxy rules intact, and it interpreted the rules as excluding proposals that might seek to provide for proxy access.[31]

Having failed at the SEC, shareholders tried another tack. After the SEC assured AIG that it could exclude a proxy access bylaw that had been proposed by AFSCME, the largest public employee union, AFSCME appealed, challenging the SEC's interpretation of its own rules. Under the shareholder proposal rule in place at the time, a corporation could exclude proposals "relating to an election." AFSCME acknowledged that a proposal to include a particular slate of directorial nominees in a company's proxy materials would "relat[e] to an election" but argued that its proposal advocating for a set of election procedures would not. In *AFSCME v. AIG*, the Second Circuit agreed, holding that AIG could not exclude the proposal.[32] A limited form of proxy access had prevailed.

Rather than accepting the Second Circuit's ruling, the SEC quickly revised its rule. The new rule explicitly stated that a corporation could exclude proposals related to "a procedure for . . . nomination or election" from its proxy materials.[33] The language now left no doubt that proxy access proposals could be excluded.

27. Sarbanes-Oxley Act, *supra* note 5, § 301, 116 Stat. at 775–77 (codified as amended at 15 U.S.C. § 78j-1 (2012)) (independent audit committee); *id.* § 402, 116 Stat. at 787–88 (codified as amended at 15 U.S.C. § 78m (2012 & Supp. III 2015)) (ban on loans); *id.* § 404, 116 Stat. at 789 (codified as amended at 15 U.S.C. § 7262 (2012)) (internal controls).

28. The prehistory of the recent proxy access debate dates back to 1942, when the SEC first promulgated its proxy rules. Shareholder advocates proposed that shareholder nominations be included in the company proxy materials as a matter of course, but managers persuaded the SEC to permit exclusion of election-related proposals. For the history, see Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129 (1993).

29. *See, e.g.*, Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329, 329–60 (2010) (surveying support for proxy access).

30. *See, e.g.*, Judith Bums, *CEOs Blast SEC Proxy Plan, While Unions Praise It,* DOW JONES NEWSWIRES (Oct. 8, 2003).

31. *See, e.g.*, Mark J. Roe, *The Corporate Shareholder's Vote and Its Political Economy, in Delaware and in Washington*, 2 HARV. BUS. L. REV. 1, 11 (2012).

32. Am. Fed'n of State, Cty. & Mun. Emps., Emps. Pension Plan v. Am. Int'l Grp., Inc., 462 F.3d 121, 123 (2d Cir. 2006).

33. 17 C.F.R. § 240.14a-8(i)(8) (2008).

The next round of the debate shifted from the SEC to Congress. When Congress enacted the Dodd-Frank Act after the 2008 financial crisis, it explicitly authorized the SEC to put a proxy access rule in place.[34] By this time, the SEC had been chastened by a barrage of criticism regarding its perceived regulatory failures during the bubble period prior to the crisis, and the SEC had begun to regulate more vigorously under Chair Mary Schapiro. In August 2010, shortly after the Dodd-Frank Act was enacted, the SEC promulgated a proxy access rule authorizing shareholders who had held at least 3 percent of a company's stock for three years to include directorial candidates in the company's proxy materials.[35]

The new proxy access rule never went into effect. The Business Roundtable immediately challenged the rule, arguing, among other things, that the rule had not been properly adopted. The D.C. Circuit agreed.[36] In a dismissive opinion written by Judge Ginsburg, the D.C. Circuit held that the SEC had failed to conduct an adequate cost-benefit analysis of the effects of the rule. In Judge Ginsburg's view, "the Commission inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters."[37]

Delaware's entry into the proxy access controversy came after the enactment of the Sarbanes-Oxley Act and prior to the Dodd-Frank Act. In early 2008, shareholders of a Delaware corporation, CA, Inc., proposed a bylaw that would require the company to reimburse the expenses of shareholders who waged successful proxy contests. The directors argued that the proposed bylaw would be illegal under Delaware law and asked the SEC for a no-action letter stating that the SEC would not challenge CA, Inc. if the company excluded the proposal from its proxy materials.[38] In a 2008 ruling responding to certified questions from the SEC, the Delaware Supreme Court agreed with the directors.[39] The court concluded that the proxy expense bylaw was *not* permissible because it could interfere with directors' discretion.[40]

A year later, in 2009, the Delaware legislature overruled the decision by statute. Delaware enacted a package of two proxy access provisions: one authorizing bylaws providing for proxy access and the other inviting bylaws for the reimbursement of proxy expenses.[41]

34. Dodd-Frank Act, *supra* note 6, § 971, 124 Stat. at 1915 (codified as amended at 15 U.S.C. § 78n (2012)).

35. Facilitating Shareholder Director Nominations, Exchange Act Release No. 33-9136, 99 S.E.C. Docket 439 (Nov. 15, 2010). The SEC also altered 14a-8(i) to make clear that proxy access bylaw proposals could not be excluded from the company's proxy materials. *Id.*

36. Bus. Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011).

37. *Id.* at 1148–49.

38. CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 229 (Del. 2008).

39. *Id.* at 239–40.

40. *Id.*

41. *See* 77 Del. Laws, c. 14, §§ 1, 2 (2009) (codified as amended at Del. Code Ann. tit. 8, §§ 112, 113 (2009)).

In one key respect, Delaware's proxy access rules are weaker than the rule that the SEC promulgated two years later. Delaware's default position is no proxy access. Until a qualified majority of a corporation's shareholders vote to approve a proxy access bylaw (or the board of directors adds proxy access to the bylaws), shareholders are not permitted to include any of their own nominees in the corporation's proxy materials. Under the SEC rule, proxy access was automatic for shareholders who met the shareholding requirements.[42] Because the SEC rule was struck down, the Delaware provisions currently are the only source of proxy access for Delaware corporations.[43]

B. The End of (Most) Shareholder Litigation Bylaws

The second upheaval in state corporate law—with its accompanying bylaw drama—has unfolded even more recently. The more recent controversy was triggered by a stunning increase in the frequency of shareholder challenges to proposed merger transactions. A decade ago, shareholders challenged less than half of all mergers involving companies with $500 million or more in assets.[44] This percentage has rapidly increased; since 2011, well over 90 percent of the mergers have been challenged.[45] Not only is nearly every merger challenged but most also draw multiple lawsuits, often filed in multiple states. Multi-forum litigation and the headache of coordinating overlapping lawsuits in different states is now the norm after a major merger transaction is announced.

In a 2010 case involving Revlon Corporation, Delaware Vice Chancellor Travis Laster hinted that forum selection clauses—that is, clauses that require any litigation to be filed in a particular state—would probably be legal under Delaware law. "[I]f boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution," he wrote, "then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes."[46] This hint seems to have inspired the boards of a number of Delaware corporations to adopt forum selection bylaws.[47] In 2013, then-Chancellor Leo Strine fielded the first

42. *See* Roe, *supra* note 31, at 14–15 (making similar point about the comparative weakness of the Delaware provisions).

43. The securities laws do contribute in one significant respect. Although Rule 14a-11 was struck down, the *Business Roundtable* case did not affect the SEC's revision of Rule 14a-8, which was implemented at the same time and no longer permits a corporation to exclude shareholder proposals to adopt proxy access or proxy expense bylaws from the firm's proxy materials. *See* Facilitating Shareholder Director Nominations, *supra* note 35.

44. Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 Iowa L. Rev. 465, 469 (2015) (finding that 39.3 percent of transactions resulted in litigation in 2005, but that by 2011, 92.1 percent were challenged).

45. *Id.*

46. *In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010). Vice Chancellor Laster noted that one Delaware corporation (NetSuite, Inc.) had a forum selection provision in its charter and another (Oracle) had one in its bylaws. *Id.* at 960 n.8.

47. *See* Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation* 11 (NEBR Working Paper No. 21362, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2622595.

challenge to the new forum selection bylaws. In *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*,[48] the chancellor upheld the bylaws. Strine vigorously rejected the plaintiffs' argument that forum selection bylaws are invalid unless they are first approved by a shareholder vote. "In an unbroken line of decisions dating back several generations," he wrote, "our Supreme Court has made clear that the bylaws constitute a binding part of the contract between a Delaware corporation and its stockholders. Stockholders are on notice that . . . the board may act unilaterally to adopt bylaws."[49] Although the bylaw in *Chevron* required shareholders to file their lawsuits in Delaware, the Delaware Chancery Court subsequently upheld a bylaw that selected another forum—North Carolina—as the forum of choice, concluding that "nothing in the text or reasoning of *Chevron* can be said to prohibit directors of a Delaware corporation from designating an exclusive forum other than Delaware in its bylaws."[50]

Less than a year after *Chevron*, the Delaware Supreme Court gave its imprimatur to an even more dramatic shareholder litigation bylaw.[51] The bylaw—which required any member of ATP Tour, Inc., the men's professional tennis tour, to reimburse the firm's fees, costs, and expenses if the member sues and "does not obtain a judgment on the merits that substantially achieves . . . the full remedy sought"[52]—came to the Delaware Supreme Court as a series of certified questions from the U.S. District Court for the District of Delaware. Adopting the same contractual logic as *Chevron*, the Delaware Supreme Court held that fee-shifting bylaws are facially valid. "Because corporate bylaws are contracts among a corporation's shareholders," Justice Berger wrote, "a fee-shifting provision . . . would fall within the contractual exception to the American Rule [which permits the parties to alter by contract the ordinary rule that each party pays its own attorney's fees]. Therefore, a fee-shifting bylaw would not be prohibited under Delaware common law."[53]

Once again, as with proxy access, the Delaware legislature quickly registered its disapproval. This time, the legislature *prohibited* the new bylaws. Almost as soon as the Delaware Supreme Court had endorsed loser-pays bylaws, the Corporation Law Council[54] proposed amendments that would forbid them.[55] The

48. 73 A.3d 934 (Del. Ch. 2013).

49. *Id.* at 956. Chancellor Strine pointedly rejected a contrary holding by the U.S. District Court for the Northern District of California, characterizing the decision as "rest[ing] on a failure to appreciate the contractual framework established by the DGCL for Delaware corporations and their stockholders." *Id.* (discussing Galaviz v. Berg, 763 F. Supp. 2d 1170, 1174 (N.D. Cal. 2011)).

50. Providence v. First Citizens Bancshares, Inc., 99 A.3d 229, 235 (Del. Ch. 2014).

51. ATP Tours, Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014).

52. *Id.* at 556.

53. *Id.* at 558.

54. The Corporation Law Council is a twenty-two-lawyer committee of the Delaware State Bar Association. The Council drafts recommended amendments to Delaware corporate law on an ongoing basis. After approval by the corporation law section and the executive committee of the bar association, Council amendments are forwarded to Delaware's General Assembly for consideration. *See About the Section of Corporation Law*, Del. St. B. Ass'n, http://www.dsba.org/sections-committees/sections-of-the-bar/corporation-law/ (last visited Oct. 9, 2016).

55. *See* Alison Frankel, *Sneaky New Trend in IPOs: Make Shareholders Pay If They Sue and Lose*, Reuters (Oct. 9, 2014), http://blogs.reuters.com/alison-frankel/2014/10/09/sneaky-new-trend-in-ipos-make-shareholders-pay-if-they-sue-and-lose/.

initial proposal came a bit too quickly for the Delaware Senate, which asked the Corporation Law Council to continue studying the issue so that it could be revisited in 2015.[56]

After the Council released its proposal,[57] the reforms were introduced and promptly enacted.[58] The reforms included a pair of amendments barring a corporation from including a loser-pays provision in either its certificate of incorporation or its bylaws.[59] Delaware lawmakers also enacted a rather remarkable new provision that allows forum selection clauses that select Delaware as the exclusive location for shareholder litigation but does not permit a forum selection bylaw to prevent shareholders from filing their lawsuit in Delaware.[60] A Delaware corporation that wishes to assure that any litigation will be brought in one or a small number of states can therefore exclude every state except Delaware.

It is important to appreciate just how unusual Delaware's recent legislative interventions are. Although Delaware often updates its corporate law and is famously quick to adopt new corporate law innovations,[61] the Delaware legislature rarely steps in to reverse the course of Delaware corporate law. Prior to the bylaw amendments, the last time lawmakers had dramatically redirected the course of Delaware law was 1986, when the legislature disavowed the closely divided Delaware Supreme Court decision in *Smith v. Van Gorkom*[62] by authorizing Delaware corporations to adopt charter provisions precluding monetary damages for breach of the director's duty of care.[63]

56. S.J. Res. 12, 147th Gen. Assemb. (Del. 2014). The Chamber of Commerce and several major corporations, including DuPont, had signaled their opposition to the proposed amendments, which may have influenced the Delaware Senate's decision to slow down the process. *See, e.g.,* Francis G.X. Pileggi, *Delaware Proposes New Fee-Shifting and Forum Selection Legislation*, DEL. CORP. & COM. LITIG. BLOG (Mar. 6. 2015), http://www.delawarelitigation.com/2015/03/articles/commentary/delaware-proposes-new-fee-shifting-and-forum-selection-legislation/.

57. *See, e.g.*, Corp. Law Council, Explanation of Council Legislative Proposal (undated) (copy on file with *The Business Lawyer*) (explaining and defending the proposed amendments).

58. The bill was introduced on April 29, 2015, enacted by the legislature on June 11, 2015, and signed by the governor on June 24, 2015. *See, e.g.,* Kevin La Croix, *Delaware Legislature Passes Fee-Shifting Bylaw Prohibition: What Questions Remain?*, THE D&O DIARY (June 14, 2015), http://www.dandodiary.com/2015/06/articles/shareholders-derivative-litigation/delaware-legislature-passes-fee-shifting-bylaw-prohibition-what-questions-remain/; Jeff C. Dodd & James Edward Malony, *Delaware Passes Legislation Prohibiting Fee-Shifting Bylaws and Validating Exclusive Forum Bylaws for Stock Corporations*, ANDREWS KURTH LLP (June 26, 2015), https://www.andrewskurth.com/insights-1230.html.

59. 80 Del. Laws, c. 40, §§ 1, 2 (2015) (codified at DEL. CODE ANN. tit. 8, §§ 102(f), 109(b) (2015)).

60. 80 Del. Laws, c. 40, § 5 (2015) (codified at DEL. CODE ANN. tit. 8, § 115 (2015)). Section 115 overrules the chancery court's endorsement of a non-Delaware exclusive forum provision in *Providence v. First Citizens Bancshares, Inc.* 99 A.3d 229 (Del. Ch. 2014). Section 115 also appears to invalidate mandatory arbitration clauses, since these bylaws and charter provisions would remove litigation in the Delaware courts as an option.

61. The classic study of Delaware lawmaking is Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1983). Romano found that Delaware was nearly always one of the earliest adopters of an innovation.

62. 488 A.2d 858 (Del. 1985).

63. DEL. CODE ANN. tit. 8, § 102(b)(7) (2015). For examples of other, less dramatic reversals by the Delaware legislature of Delaware court rulings, see Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749 (2006).

But the Delaware legislature has now stepped in twice in six years, once to permit what was banned, and once to ban what was permitted. What in the world is Delaware doing?

II. A Doctrinal Explanation?

It is possible that an explanation can be found in Delaware doctrine. Sudden shifts in the law sometimes reveal themselves, on more careful inspection, to have arisen organically, as a logical outgrowth of existing doctrinal tendencies.[64] Here, too, doctrine will carry us further than we might initially suspect.

The first puzzle for a doctrinal account of Delaware's handling of the new bylaws is explaining why one set of bylaws was permissible but the other was not. The challenge is particularly acute given that the Delaware courts and Delaware lawmakers drew opposite conclusions about the two sets of bylaws.

Let us start with the Delaware courts. Perhaps there is something about proxy access that makes it inherently less appropriate than shareholder litigation rules for inclusion in a corporation's bylaws. But the logic that would lead to this conclusion is not obvious. Rules for directorial nominations—the focus of proxy access—fit comfortably with the traditional understanding of bylaws as general operating rules governing the relationships among directors, officers, and shareholders.[65] If anything, proxy access is a more, not less, suitable subject for bylaws than shareholder litigation rules because shareholder litigation is, in a sense, a breakdown of the company's ordinary operating rules.

If we construe the holding in *CA, Inc.* narrowly—as being concerned with the lack of nuance in the bylaw considered by the Delaware Supreme Court, rather than ruling out proxy access bylaws altogether—the distinction is less jarring. In this view, the problem was simply that the proposed proxy expense bylaw went too far. The Delaware Supreme Court's framing of the question before it arguably supports this reading: "we must necessarily consider *any* possible circumstance under which a board of directors might be required to act."[66] But the puzzle is not solved. The bylaw that the Delaware Supreme Court approved in its loser-pays decision was remarkably unnuanced. Read literally, it would force plaintiffs to pay the directors' expenses in nearly every case, because the bylaw calls for fee

64. The classic, though still contested, example is the U.S. Supreme Court's famous "switch in time" in 1937. Though the switch has long been attributed to political expediency—the Justices feared that the Roosevelt administration would restructure the Court—revisionist scholars now contend that the shift was foreshadowed by the Court's earlier cases. *See* Barry Cushman, Rethinking the New Deal Court (1998).

65. During the late 1990s debate over poison-pill bylaws, for instance, Jeffrey Gordon and John Coffee each suggested that structural issues are suitable for bylaws but ordinary business decisions are not. Jeffrey N. Gordon, *"Just Say Never?" Poison Pills, Deadhand Pills, and Shareholder-Adopted Bylaws: An Essay for Warren Buffett*, 19 Cardozo L. Rev. 511, 547–49 (1997); John C. Coffee, Jr., *The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?*, 51 U. Miami L. Rev. 605, 613–14 (1997). Proxy access bylaws clearly are structural. *But see* Hamermesh, *supra* note 13, at 433–44 (questioning this and other rationales offered in support of poison-pill bylaws).

66. CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 238 (Del. 2008) (emphasis added).

shifting unless the plaintiffs got everything they asked for.[67] Yet the court seemed much less concerned with the details of the bylaw and was more willing to construe it charitably than with proxy access.

A more promising approach is to consider which corporate decision maker proposed the bylaws, rather than (or in addition to) the bylaws' content. Perhaps the key difference is that directors—the proponents of the shareholder litigation bylaws—have broader scope to adopt bylaws in Delaware than shareholders, who are the advocates of proxy access. To be sure, this distinction does not flow smoothly from the Delaware corporate law statute itself. The bylaw provision privileges shareholders, giving them an indefeasible right to adopt bylaws, whereas directors do not have bylaw authority unless it is conferred on them by their corporation's charter.[68] But Delaware corporate law explicitly states that the corporation is managed by or under the direction of the board of directors.[69] The Delaware courts often point to this provision as justifying substantial deference to directors' decisions,[70] and shareholder bylaws that alter the corporation's governance can be seen as undermining directorial oversight.[71]

According to this logic, the Delaware Supreme Court rejected the proxy access bylaw because it might interfere with directorial discretion to decide whether to pay expenses. But directors were the ones who adopted the shareholder litigation bylaws, and these bylaws did not interfere with the directors' discretion. The shareholder litigation bylaws were therefore less problematic.

This does, in fact, seem to be the reasoning underlying the cases. In *CA, Inc.*, the Delaware Supreme Court emphasized that "the DGCL has not allocated to the board and the shareholders the identical, coextensive power to adopt, amend and repeal the bylaws."[72] The key distinction lies in the fact that directors are the ones given authority over the business and affairs of the corporation, whereas "[n]o such broad management power is statutorily allocated to the shareholders."[73] Because the proxy expense bylaw could prevent the directors from exercising their fiduciary oversight, it was inconsistent with Delaware law.[74]

67. If the plaintiffs claimed $50 million in damages, for instance, but only obtained $40 million, they would be responsible for paying the defendants' fees, despite the obvious success of the litigation.

68. Del. Code Ann. tit. 8, § 109 (2015). In practice, corporations routinely give bylaw authority to the directors. I have not yet encountered a substantial Delaware firm that withheld this power from its directors.

69. *Id.* § 141(a).

70. *See, e.g.*, Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989).

71. *See, e.g.*, Hamermesh, *supra* note 13, at 431 (emphasizing section 141(a) as the key limitation on shareholders' bylaw authority).

72. CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 231 (Del. 2008).

73. *Id.* at 232.

74. Justice Jacobs was concerned that the bylaw would require reimbursement even if "the proxy contest is motivated by personal or petty concerns," despite the Delaware requirement that expenses only be reimbursed in contests over substantive policy. *Id.* at 240.

So far so good. One might quibble with the extent of Delaware's solicitude for directorial discretion[75] and with the constraints this imposes on shareholders. But the divergent decisions can be explained by a consistent principle.

When we turn to the Delaware legislature's role in the drama, the underlying doctrinal principle is not so readily apparent. If the lawmakers shared the Delaware judges' concern for directorial discretion, they surely would have drafted the new bylaw (and charter) provisions differently. When the legislature explicitly authorized proxy access and expense bylaws, for instance, it could have included a proviso giving the directors authority to intervene in cases such as the "personal or petty" proxy contest with which Justice Jacobs was concerned. The legislature's response to shareholder litigation bylaws is even harder to reconcile with the logic of the Delaware cases. The ban on loser-pays bylaws and restriction of forum selection bylaws have curbed directorial discretion, not protected it.

Perhaps the implicit assumption that I have been using so far—the assumption that the Delaware courts and legislature are pursuing the same underlying objective—is the wrong way to proceed. Although Delaware's courts and legislature are closely linked, the legislature could have been pursuing a different doctrinal objective. The most obvious candidate is a perception that Delaware's courts went a little too far in their zeal to protect directorial discretion. According to this reasoning, the Delaware legislature intervened to adjust the balance of authority between directors and shareholders in a more shareholder-oriented direction.

This structural perspective is a much more plausible explanation for the legislature's handling of the two sets of bylaws. Shareholders' most important corporate law protections are voting rights and their position as the principal beneficiaries of the directors' fiduciary duties.[76] The Delaware courts' bylaw decisions can be seen as eroding each of these protections. By calling proxy access bylaws into question, the Delaware Supreme Court not only interfered with an effort to make it easier for shareholders to contest directorial elections, but it also signaled that the shareholders' right to enact bylaws is subject to significant limitations. Similarly, the court's endorsement of fee-shifting bylaws threatened to undermine shareholders' ability to enforce directors' fiduciary duties. Shareholders and plaintiffs' attorneys would be far more hesitant to bring fiduciary

75. Ironically, these decisions might have been influenced to some extent by the way that directorial discretion emerged as a key factor in Delaware's review of "dead hand" and "no hand" poison pills, which were designed to prevent hostile bidders from removing a poison pill even after the bidder successfully replaced the current board of directors. Carmody v. Toll Bros., Inc., 723 A.2d 1180 (Del. Ch. 1998); Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281 (Del. 1998). When Delaware struck down dead hand and no hand pills because they interfered with the discretion of future boards, it was enhancing the power of shareholders vis-à-vis directors by removing an obstacle to shareholder activism. With proxy access, by contrast, the emphasis on directorial discretion diminished shareholder power by striking down a provision that would have provided funding for successful shareholder activism.

76. The next most important protection is appraisal rights—the right to insist that the corporation buy the shareholders' shares at a price set by the Delaware Chancery Court. Appraisal rights are generally limited to the merger context, however, and not all mergers at that. Del. Code Ann. tit. 8, § 262(b) (2015).

duty litigation against directors if they faced the prospect of bearing both parties' costs in the litigation.

The doctrinal picture that has emerged—which suggests that the Delaware courts were concerned with protecting directorial discretion while Delaware lawmakers intervened to limit the interference with the two key shareholder protections—does seem to capture the broad contours of Delaware's response to proxy access and shareholder litigation bylaws. But it raises two very big sets of questions.

First is the question of timing: Why did Delaware lawmakers intervene so quickly on each occasion, rather than waiting for the developments to play out? The Delaware Supreme Court had not said that every proxy access bylaw is invalid; rather, it raised doubts about a proxy expense bylaw that precluded directors from withholding reimbursement if reimbursement would violate Delaware law.[77] If the legislature had not intervened, perhaps shareholders would have devised more carefully tailored bylaws, and these bylaws would have survived judicial scrutiny. Similarly, if the Delaware legislature had waited, the use of shareholder litigation bylaws might have evolved in directions that did not interfere with shareholder litigation. The leading advocates for directorial discretion did not rush to embrace loser-pays bylaws, perhaps because they feared the wrath of shareholder advisory groups.[78] Perhaps loser-pays bylaws would have remained a curiosity, used by unusual firms such as the men's tennis tour, but not by significant numbers of publicly held corporations.

Second, if Delaware lawmakers were concerned with protecting shareholders, why did the protections take this particular form? In each instance, the legislature adopted narrow amendments that applied only to the issues in question—proxy access and specific kinds of shareholder litigation bylaws.[79] Odder still, the legislature used a default rule with proxy access—a default rule that started with a presumption of no access—whereas its new shareholder litigation amendments imposed mandatory rules. It is not clear why default rules are appropriate in one context, and mandatory provisions are appropriate in the other.

The doctrinal account I have developed in this part captures key features of the oddly divergent responses of Delaware's courts and its legislature to the recent bylaw issues. But the doctrinal explanation is incomplete. To more fully understand the unusual recent developments in Delaware, we need to consider the other imperatives that may have also shaped Delaware's handling of the two sets of bylaws.

77. *CA, Inc.*, 953 A.2d at 238–40.

78. Wachtell, Lipton, Rosen & Katz, the law firm best known for defending directors, counseled its clients that "'caution is in order' because of court skepticism and likely the 'vigorous' opposition of 'shareholder groups and proxy advisors.'" *See* Steven Davidoff Solomon, *A Ruling's Chilling Effect on Corporate Litigation*, N.Y. TIMES DEALBOOK (May 23, 2015, 5:01 PM), http://dealbook.nytimes.com/2014/05/23/a-rulings-chilling-effect-on-corporate-litigation/?_r=0 (quoting Wachtell, Lipton client letter).

79. Moreover, the insistence that forum selection bylaws include a Delaware option also does not appear to have been designed with shareholder protection in mind.

III. Delaware's Political Imperatives

By the early 2000s, most corporate law scholars had concluded that state charter competition is not much of a competition and that Delaware law tends to strike a balance between the interests of its two main constituencies—managers (and directors) and shareholders.[80] Thus, charter competition is not really a race either to the top or to the bottom; it is a race to somewhere in between.[81] Delaware has won the race because no other state can seriously challenge it as the premier state of incorporation.[82]

The past decade has made clearer than ever before that Delaware does face one truly formidable competitor: the United States Congress.[83] The more Congress intrudes on state corporate law—the more issues are dictated by federal law—the less Delaware incorporation has to offer. Delaware therefore has a strong interest in keeping Congress at bay.

Scholars have long been aware that the Delaware courts have occasionally handed down rulings that seemed intended to appease Congress. In 1977, Delaware tightened its scrutiny of mergers designed to cash out minority shareholders[84] after critics complained that controlling shareholders were taking advantage of temporarily deflated stock prices, a concern that featured prominently in calls made by Ralph Nader and others for Congress to federalize corporate law.[85] After the Delaware Supreme Court imposed a new "business purpose" requirement, the federalization ferment subsided.[86] Astute Delaware watchers also pointed to the Delaware Supreme Court's *Time-Warner* decision[87] as influenced by developments in Congress.[88] By 1989, when *Time-Warner* arose, the takeover

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80. For a particularly nuanced version of this view, see Mark J. Roe, *Delaware's Politics*, 118 Harv. L. Rev. 2491 (2005) (analyzing Delaware's interactions with Congress from the perspective of positive political theory); *id.* at 2518–19 (describing managers' and shareholders' joint interest that key issues be regulated by Delaware rather than Congress).

81. The foremost current advocates of the race-to-the-top and race-to-the-bottom views are Roberta Romano and Lucian Bebchuk. *See, e.g.*, Roberta Romano, The Genius of American Corporate Law (1993); Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 Harv. L. Rev. 1435 (1992). The literature dates back to William Cary's articulation of the race-to-the-bottom view and Ralph Winter's race-to-the-top response. William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 Yale L.J. 663 (1974); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. Legal Stud. 251 (1977).

82. Indeed, the most noteworthy new contribution at the outset of the 2000s was Marcel Kahan and Ehud Kamar's work demonstrating that Delaware behaves like a monopolist in state corporate law, charging supracompetitive prices through its franchise tax. Kahan & Kamar, *supra* note 1.

83. *See* Mark J. Roe, *Delaware's Competition*, 117 Harv. L. Rev. 588 (2003).

84. Singer v. Magnavox, 380 A.2d 969 (Del. 1977).

85. *See, e.g.*, Ralph Nader, *The Case for Federal Chartering, in* Corporate Power in America 67, 79 (Ralph Nader & Mark J. Green eds., 1973).

86. *See, e.g.*, William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism*, 41 Wake Forest L. Rev. 619, 680 (2006) (discussing the perception that the new business purpose test, as announced in *Singer v. Magnavox*, 380 A.2d 969 (Del. 1977), was intended to quiet calls for federalization of corporate law).

87. Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989).

88. *See, e.g.*, Jeffrey N. Gordon, *Corporations, Markets, and Courts*, 91 Colum. L. Rev. 1931, 1971 (1991) (speculating that the Delaware Supreme Court may have been concerned about federal intervention but developing a more general "socio-historical" account).

wave of the 1980s was criticized by many as out of control, and calls for federal intervention proliferated.[89] *Time-Warner* deflated the outrage by shifting Delaware doctrine in a noticeably pro-target direction, upholding the resistance from Time Inc.'s directors to a lucrative hostile takeover bid by Paramount.

As real as the threats seemed at the time, they were distant and episodic compared to the tensions between Delaware and Congress that have arisen in the past decade and a half. After the corporate scandals of the early 2000s, Congress federalized significant swaths of state corporate law with the Sarbanes-Oxley Act, which added numerous new provisions to the Securities and Exchange Act of 1934.[90] After the Great Recession of 2008, the Dodd-Frank Act continued Congress's incursion into state corporate law. As noted earlier, the Dodd-Frank Act imposes a "say on pay" vote on compensation, requires banks to create an independent risk committee, and explicitly authorizes the SEC to establish proxy access.[91]

Delaware unveiled its proxy access bylaw rules in 2009, after the debates on the proposals that gave rise to the Dodd-Frank Act had begun, but well before the federal legislation took its final form.[92] It is possible that that the Delaware lawmaking process fit Delaware's usual pattern of roughly balancing the interests of managers and shareholders. Because shareholders were the strongest proxy access advocates, even though managers opposed it, perhaps Delaware adopted a compromise: Delaware law presumes that shareholders do not have proxy access, in a nod to managers' wishes. But if shareholder advocates persuade their fellow shareholders to adopt a proxy access bylaw, proxy access can be adopted. This explanation is consistent with the doctrinal explanation developed in the last part.

There are several obvious flaws in this account, however. The first is that the Delaware provisions actually secured very little for shareholders. An insurgent shareholder who made use of the Delaware provisions would need to wage two proxy contests—the first to secure the proxy access bylaws and the second to take advantage of the bylaws. At the time Delaware enacted its proxy access provisions, the shareholder was forced to bear the entire cost of the initial campaign.[93] From the insurgent's perspective, it would be faster and might not be enormously more expensive simply to wage an all-out proxy contest in the first year, rather than embark on a two-year, two-stage campaign.[94] Even if

89. *See id.*

90. For criticism, see Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, REG., Spring 2003, at 26, 31 (describing and critiquing the increased federalization of corporate law).

91. *See supra* notes 6–8 and accompanying text.

92. Senator Chuck Schumer had included proxy access in the "shareholder bill of rights" that he proposed at the outset of the discussions that led to passage of the Dodd-Frank Act. Shareholder Bill of Rights Act, S. 1074, 111th Cong. § 4 (2009).

93. Since 2010, shareholders' initial effort has been partially subsidized by the SEC's revision of Rule 14a-8, which no longer permits a corporation to exclude proxy access bylaw proposals from its proxy materials.

94. Roe makes a similar point about the limitations of the Delaware provisions. Roe, *supra* note 31, at 16–17.

the new rules were more valuable to shareholders than I have suggested, it still is not clear why the Delaware legislature was in such a rush to intervene. As noted earlier, the Delaware Supreme Court had not outlawed proxy access altogether.[95] The Delaware legislature might easily have waited to see whether a second generation of proxy access bylaws satisfied the court's concerns. But it did not.

The haste of Delaware's intervention suggests that Delaware was responding to something else—the SEC and Congress. As Mark Roe has pointed out, Delaware seems to have been trying to subtly preempt federal regulators and Congress by establishing a framework for proxy access before Congress completed its work on the Dodd-Frank Act.[96] In a sense, Delaware may have been trying to signal that there was no need to enact a federal proxy access provision, because Delaware had already taken care of the problem.[97] If the stratagem worked, Delaware could repel a significant federal intrusion into state corporate law, and it could determine the form that the new proxy access regime took.

The contrast between Delaware's proxy access rules and their federal counterpart is revealing in this regard. Any federal proxy access rule was likely to be mandatory: publicly held corporations would be required to offer proxy access to qualifying shareholders.[98] By contrast, the Delaware framework did not provide for proxy access unless shareholders waged a successful campaign to enact a proxy access bylaw. From this perspective, Delaware lawmakers' decision to intervene looked like an effort to ensure that proxy access took a less sweeping form than federal regulators had in mind.[99]

In the short run, Delaware's gambit seemed to have failed. Congress included proxy access in the Dodd-Frank Act,[100] despite Delaware having enacted a state law version of proxy access. Promptly after Dodd-Frank, the SEC enacted a mandatory proxy access rule.[101] But the Delaware regime has governed proxy access since the SEC's proposed proxy access rule was struck down, and the SEC shows no signs of revisiting proxy access and proposing a new proxy access rule.[102]

95. *See supra* note 77.

96. Roe, *supra* note 31, at 27.

97. As Delaware prepared to pass its proxy access provisions, one prominent Delaware lawyer opined that "there isn't much reason for the SEC to try to create a whole new proxy access scheme that would preempt state law when state law had already provided for access." Yin Wilczek, *Proxy Access: Schapiro Directs Staff to Draft Proxy Access Proposals*, Corp. Couns. Weekly, Mar. 11, 2009, at 1, 2.

98. The rule that the SEC promulgated after the enactment of the Dodd-Frank Act was indeed mandatory. For a description, see *supra* note 35 and accompanying text.

99. In some respects, the short-lived SEC rule was more limited than the Delaware provisions. It would have limited proxy access to shareholders that had held 3 percent of a corporation's stock for at least three years and would have required these shareholders to disavow any interest in control of the corporation. *See, e.g.*, Marcel Kahan & Edward B. Rock, *The Insignificance of Proxy Access*, 97 Va. L. Rev. 1347 (2011). The Delaware provisions allowed proxy access bylaws that omitted or reduced these restrictions.

100. *See supra* note 8.

101. *See supra* note 35. For a skeptical assessment of the SEC's proxy access rule, suggesting it would have little practical effect, see Kahan & Rock, *supra* note 99.

102. One qualification: The D.C. Circuit in *Business Roundtable* only struck down the SEC's proxy access rule (former Rule 14a-11), not new Rule 14a-8(i), which limits the corporation's right to exclude proxy access bylaws from its own proxy materials. As a result, shareholders' initial campaign

Given how well it explains Delaware's 2009 proxy access reforms, the preemption-of-SEC-and-Congress thesis is an obvious candidate for making sense of Delaware's equally rapid legislative intervention in 2015. According to the preemption thesis, Delaware quickly intervened, lest Congress step in and further federalize corporate law by enacting a new set of rules governing shareholder litigation.

As with proxy access, preemption does seem to better explain Delaware's 2015 bylaw reforms than a traditional account suggesting that Delaware was simply balancing the interests of managers and shareholders, as it often does. One problem for the business-as-usual account is that the new shareholder litigation bylaw rules do not look like a traditional compromise. To the contrary, they look like a pure victory for shareholders at managers' expense. Indeed, managers' principal lobbying organizations mounted an energetic campaign to halt the Delaware legislation when it was first announced in 2015.[103] Delaware's haste to intervene is similarly confounding for the business-as-usual account. Why intervene so quickly, especially given the opposition from managers? Consider, by way of contrast, Delaware's response to other states' enactment of antitakeover legislation in the 1980s. In the face of support from managers of potential targets and opposition from bidders and shareholders, Delaware dallied, finally enacting a tepid antitakeover law long after other states had adopted more vigorous restrictions on takeovers.[104]

The rush to ban shareholder litigation bylaws is even more puzzling given the dearth of evidence that these provisions would quickly become a standard feature of corporate charters and bylaws. Only forty-nine corporations (forty of which were incorporated in Delaware) had adopted loser-pays bylaws or charter provisions by the time Delaware banned them.[105] Given managers' hostility to the ban and the newness of the issue, Delaware's haste is hard to explain.

At first glance, the preemption-of-SEC-and-Congress thesis provides a much more plausible explanation. Perhaps Delaware took immediate action lest Congress intervene first. If we consider the actual posture of Congress in 2015, however, the likelihood of federal intervention seemed quite remote.[106] In contrast to 2009, when federal lawmakers were actively debating the legislation that became the Dodd-Frank Act, there was no obvious threat of federal legislation in 2015. Shareholder litigation bylaws were not on anyone's radar screen in Washington, D.C. Moreover, even if some lawmakers had eagerly sought to assert federal

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to adopt a proxy bylaw is now partially subsidized—because the company itself pays the cost of distributing the proxy materials.

103. *See* Pileggi, *supra* note 56 (describing opposition by the U.S. Chamber of Commerce and corporations such as DuPont).

104. Delaware section 203 does little other than require a supermajority vote for a second-stage merger after an acquisition. For discussion of Delaware's delay, see Romano, *supra* note 81.

105. According to one observer writing in early 2015, thirty-nine fee-shifting bylaws or certificate provisions had been adopted. Claudia H. Allen, *Fee-Shifting Bylaws: Where Are We Now?*, Corp. L. & Accountability (BNA) Rep., Jan. 16, 2015, at 2, 2–3. Bill Seidleck updated this information by checking for additional fee-shifting terms up to the date Delaware banned loser-pays provisions (search details on file with the author).

106. Jill Fisch has made a similar point. Fisch, *supra* note 15.

authority over shareholder litigation, Congress does not seem likely to enact business or financial legislation of any kind in the current political environment. Finally, when Congress *has* gotten interested in these issues in the past several decades, it has tended to tighten the rules of shareholder litigation, not to protect plaintiffs' attorneys and shareholders. In the 1990s, lawmakers twice enacted laws that were intended to impose greater oversight of and tougher pleading standards on plaintiffs' attorneys.[107] It is hard to imagine a Republican-controlled Congress suddenly discovering a passion to intervene on plaintiffs' attorneys' behalf.

However, Congress is not the only federal threat to Delaware. The SEC and other federal regulators can also encroach on Delaware's authority. With loser-pays bylaws and charter provisions in particular, there were hints that the SEC might intervene and impose tighter regulatory scrutiny on corporations that adopted loser-pays bylaws or included a loser-pays provision in their certificate of incorporation at the time of their IPO.[108] But Delaware's ban on loser-pays bylaws and certificate provisions looks much less like an effort to outmaneuver Washington than its handling of proxy access. If Delaware were trying to implicitly preempt the SEC, it might have limited loser-pays provisions without banning them altogether. Delaware could have permitted fee shifting only in cases where the plaintiffs were entirely unsuccessful, for instance. But this is not what Delaware did.

Delaware's hasty intervention and complete ban of loser-pays provisions does not seem to have been triggered by a concern to preempt Congress or federal regulators. Yet these features suggest that Delaware lawmakers thought they were reacting to a serious threat. What threat did they have in mind?

IV. The Credibility Conundrum

Neither the standard account nor the preemption-of-SEC-and-Congress thesis fully explains why Delaware lawmakers decisively intervened in 2015. The lawmakers acted as if they faced a crisis, but their response seemed disproportionate to the magnitude of the perceived crisis. In this part, I try to supply an answer both to the general question of why Delaware lawmakers intervened and to the narrower but more interesting question of why they stepped in so quickly.

The first thing to note is that Delaware needs cases; corporate law litigation is the fuel that powers the mighty Delaware corporate law engine. Although Delaware's corporate law statute is well regarded, it could easily be replicated by

107. Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 U.S.C.); Securities Litigation Uniform Standards Act, Pub. L. No. 105-353, 112 Stat. 3227 (1998) (codified as amended in scattered sections of 15 U.S.C.).

108. For a column by a leading corporate law scholar advocating SEC intervention, see John C. Coffee, Jr., *Fee-Shifting and the SEC: Does It Still Believe in Enforcement?*, Colum. L. Sch. Blue Sky Blog (Oct. 14, 2014), http://clsbluesky.law.columbia.edu/2014/10/14/fee-shifting-and-the-sec-does-it-still-believe-in-private-enforcement/. Coffee notes that the Carlyle Group dropped a mandatory arbitration provision from its charter after criticism by regulators and investors, and he suggests that a similar strategy could be used with loser-pays bylaws and charter provisions. *Id.* n.22.

other states. What sets Delaware apart is its sophisticated corporate law judiciary and its rich supply of precedents on any conceivable corporate law issue.[109] Even Delaware's critics acknowledge that Delaware's judiciary is what makes Delaware special.[110] When a challenging new issue emerges in corporate law—such as the question of whether target directors should be permitted to defend against a takeover bid in the 1980s or the scope of permissible bylaws in the 1990s and 2000s—the key early case or cases are usually filed in Delaware, and these cases enable Delaware's judges to shape the emerging law.

Although Delaware is often the most obvious place for plaintiffs to file their corporate complaints, it is almost never the only possible filing location, because most Delaware corporations have their headquarters and principal place of business elsewhere.[111] If shareholders started filing their lawsuits in other states, the Delaware engine would soon begin to struggle. Three decades ago, Jonathan Macey and Geoffrey Miller pointed out some of the measures Delaware takes to encourage litigants to file their cases in the state.[112] For instance, Delaware makes it very easy to obtain personal jurisdiction over the directors of Delaware corporations.[113] The Delaware courts also are quite generous in awarding attorney's fees to plaintiffs' attorneys who prevail in litigation.[114]

Despite these inducements, an increasing number of cases have been filed in other jurisdictions since the early 2000s or have been filed by multiple plaintiffs in multiple jurisdictions. In the most extensive study of this phenomenon thus far, Armour, Black, and Cheffins found that 60 percent of all cases involving Delaware corporations were filed in Delaware until 2001, but this percentage dropped below 40 percent from 2002 on.[115] Many of these cases are challenges to mergers.[116] In the past few years, shareholder plaintiffs have challenged nearly every substantial merger. Different plaintiffs file lawsuits in different states, and the courts face the challenge of coordinating the lawsuits and ensuring that they are resolved in a coherent fashion.

Exclusive forum clauses seemed to be an elegant solution to the multi-forum litigation problem. If a firm's directors adopted a bylaw or certificate provision

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109. *See, e.g.*, Armour et al., *supra* note 9, at 606 ("Delaware's Chancery Court is thought to be an important factor in Delaware's dominance.").

110. *See, e.g.*, Bebchuk, *supra* note 81, at 1471.

111. DuPont is (at least until the completion of its merger with Dow Chemical Company) one of the few publicly held Delaware corporations that is headquartered in Delaware. Nearly all of Delaware's other corporations are headquartered elsewhere.

112. Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987).

113. *Id.* at 512 (discussing DEL. CODE ANN. tit. 10, § 3114, which was enacted immediately after the Delaware statute authorizing the chancery court to compel the appearance of directors was declared unconstitutional in *Shaffer v. Heitner*, 433 U.S. 186 (1977)).

114. *Id.* at 497 (pointing out that Delaware "awards attorney's fees based on the relief obtained rather than the number of hours reasonably expended" and that this is "widely believed, at least in the Delaware bar, to be much more generous than the fees obtained through an hourly fee 'lodestar' approach"); Armour et al., *supra* note 9, at 643 (same).

115. Armour et al., *supra* note 9, at 621.

116. *See, e.g.*, Cain & Solomon, *supra* note 44, at 468 (describing merger litigation as the "dominant form of corporation litigation"), 476 (documenting increase in multi-forum litigation).

requiring that the parties bring any litigation in Delaware, the multi-forum litigation problem would disappear. Shareholders would only file their lawsuits in Delaware. It is perhaps not surprising that, when firms did not adopt these clauses on their own, perhaps because of uncertainty as to whether they were allowed under Delaware law, the Delaware Chancery Court signaled that the clauses were likely to be permissible.[117] Vice Chancellor Laster's dicta prompted numerous exclusive forum clauses, and the number increased still further after the Delaware Supreme Court appeared to give its imprimatur.[118]

Delaware's elegant solution had a potential dark side, however. The same doctrinal logic that justified Delaware forum clauses seemed to suggest that firms can adopt other shareholder litigation clauses that do not bode quite so well for Delaware. Shortly after the Delaware Chancery Court explicitly upheld an exclusive forum bylaw that specified Delaware as the forum, it was forced in another case to address a Delaware corporation's choice of North Carolina as its exclusive forum.[119] Next came the loser-pays bylaw, which is even worse from Delaware's perspective because it would seriously chill litigation and might be especially attractive to corporate managers and directors.[120] But the same logic that justified bylaws selecting Delaware as the exclusive forum seemed to apply to the less-welcome bylaws, and the Delaware courts duly upheld them.

From this perspective, the 2015 intervention looks like a simple midstream correction. The Delaware courts had welcomed exclusive bylaws as a solution to the multi-forum litigation problem, but the solution had itself become a problem. The Delaware legislature fixed the problem, preserving the beneficial features of the new bylaws and removing their cancerous (for Delaware) attributes.

Although this explanation is plausible—in my view, it is compelling—we have not yet answered the questions posed at the outset of Part IV. Why did Delaware lawmakers feel the need to intervene rather than letting the Delaware courts continue to wrestle with the cases, at least initially? And why did the Delaware legislature step in so quickly?

If we glance at the actual pattern of bylaw adoption, the mystery deepens. As of August 2014, 93 percent of the exclusive forum provisions adopted by Delaware firms specified Delaware as the exclusive forum, and there was no evidence that this percentage was shifting.[121] As noted earlier, forty-nine corporations adopted a loser-pays bylaw or charter provision prior to the Delaware legislature's intervention.[122] Whatever threat Delaware faced does not appear to have been imminent. Yet Delaware lawmakers took charge almost immediately. Why the rush?

117. *In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010).

118. Romano & Sanga, *supra* note 47, at 29 ("Since the [Delaware Supreme Court] decision, exclusive forum clauses adoption has grown at a constant linear rate of over 15 percentage points per year").

119. Providence v. First Citizens Bancshares, Inc., 99 A.2d 229 (Del. Ch. 2014).

120. *Cf*. Macey & Miller, *supra* note 112, at 511 (arguing that Delaware's failure to adopt a security for expenses provision, which reduces derivative litigation, benefitted the Delaware bar at the expense of Delaware managers).

121. Romano & Sanga, *supra* note 47, at 23.

122. *See supra* note 105.

It is possible that the forty-nine loser-pays provisions were the front end of a tidal wave and that these provisions soon would have become far more common. Moreover, plaintiffs' attorneys who challenged a draconian loser-pays bylaw would risk being forced to bear both parties' expenses if the challenge failed. This risk might chill challenges.[123] Yet one still would expect Delaware to wait until it became clear that the threat was real rather than intervening so quickly. It seems quite likely that the provisions would have been challenged, despite the potential costs to the plaintiffs' lawyers.

A more plausible explanation for the prompt intervention, and one that has been credited by some Delaware watchers, is that it simply reflects successful lobbying by Delaware trial lawyers, a key Delaware interest group.[124] According to this view, the leading plaintiffs' lawyers convinced Delaware's Corporation Law Council to propose the reforms. The defense bar also stood to benefit from the legislative intervention. By banning loser-pays clauses, the legislature protected corporate litigation, and by forbidding non-Delaware exclusive forum clauses, it increased the likelihood that the cases would be filed in Delaware. The reforms benefitted Delaware's corporate law bar more than any other constituency, and Delaware lawyers seem to have actively promoted the reforms. One of the most influential Delaware trial lawyers is an active member of the Council,[125] and another well-known Delaware plaintiffs' lawyer recently wrote a long article condemning the perverse effects of multi-forum litigation.[126] Although it would be unusual for Delaware plaintiffs' attorneys to win such a decisive legislative victory, they had several key advantages in this context. First, although corporate managers opposed the 2015 changes, the harm to managers was somewhat limited given that managers generally benefit from Delaware's exclusive forum provisions, and the managers of any corporation that adopted a loser-pays provision could expect to face stiff criticism from shareholder advisory services and other governance advocates.[127] In addition, the interests of Delaware's corporate lawyers nicely align with Delaware's own interests in this context, because both benefit from cases being brought in Delaware rather than elsewhere.[128]

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123. John Coffee made a similar argument in testimony to the SEC's Investor Advisory Committee. Testimony of Professor John C. Coffee Jr. Before the SEC Investor Advisory Committee, U.S. Sec. & Exch. Comm'n, Washington, D.C. 8 (Oct. 9, 2014) (stating that the "defendant's expenses in a securities class action can easily exceed $10 million, and this amount would bankrupt many smaller plaintiff's law firms").

124. Macey & Miller give a similar account of the Delaware sequestration statute that the U.S. Supreme Court later struck down as unconstitutional, noting that several of the lawyers on the Delaware Corporate Law Revision Commission "'freely admitted that they voted for retaining sequestration because it means more business for them.'" Macy & Miller, *supra* note 112, at 512.

125. Stuart Grant of Grant & Eisenhofer P.A.

126. Joel Edan Friedlander, *How* Rural/Metro *Exposes the Systemic Problem of Disclosure Settlements*, 41 Del. J. Corp. L. (forthcoming 2016).

127. *See, e.g.*, Solomon, *supra* note 78 (describing criticism of loser-pays bylaws by Institutional Shareholder Services).

128. Similarly, if the managers of Delaware corporations responded to the ban on loser-pays provisions by reincorporating in states that allow the provision, both Delaware itself and its corporate lawyers would suffer.

The principal limitation of the simple-interest-group explanation is that it does not explain why Delaware lawmakers took such a dramatic step at a time when victory in the battle against multi-forum litigation already seemed to be in sight. Exclusive forum provisions selecting Delaware as the forum were steadily increasing. Why not leave matters to the parties themselves and to the Delaware courts? After all, Delaware judges benefit when cases are brought in Delaware, just as Delaware trial lawyers and Delaware itself do. The distinctive prestige of being a Delaware chancery court judge depends on Delaware's status as the preeminent state of incorporation.[129] One might suspect that, over time, Delaware's courts would interpret shareholder litigation bylaws and charter provisions in a Delaware-friendly fashion.[130] The judges might narrowly construe the right to select a non-Delaware exclusive forum, for instance, or the scope of permissible loser-pays bylaws.[131]

Although the judicial incentives that I have just described would appear to make the 2015 legislative intervention unnecessary, they may also have had precisely the opposite effect. The apparent incentive of Delaware's judges to discourage the use of loser-pays and non-Delaware forum bylaws may have encouraged Delaware's lawmakers to step in. I do not mean to suggest that the influence of the Delaware corporate law bar was irrelevant. It probably was quite important. But another key factor, oddly enough, may have been the credibility of the Delaware judiciary. By credibility, I mean observers' confidence that judges' self-interest is not distorting their decision making, and their general confidence in the authority of the court.

To appreciate how judicial credibility comes into play, we need to briefly consider the role that Delaware judges play in corporate law and the somewhat awkward position they have found themselves in with recent shareholder litigation.

The Delaware courts have long considered themselves to be the moral arbiters of American corporate law.[132] Not only do the Delaware courts determine ques-

129. Judge Posner has explored the role of prestige in judicial behavior in a variety of contexts. *See, e.g.*, Richard Posner, Overcoming Law 109–44 (1995); Richard A. Posner, *What Do Judges Maximize? (The Same Thing Everybody Else Does)*, 3 S. Ct. Econ. Rev. 1 (1993); *see also* Lee Epstein, William M. Landes & Richard A. Posner, The Behavior of Federal Judges: A Theoretical and Empirical Study of Rational Choice (2013).

130. One risk, by contrast, is that non-Delaware judges would interpret the bylaws and charter provisions in favor of *their* state, declining to enforce a Delaware-only bylaw when plaintiffs' lawyers brought the litigation in another state. Clear statutory authorization of Delaware-only bylaws and charter provisions could reduce the risk that non-Delaware courts would subvert them.

131. One can perhaps see hints of this possibility in the *First Citizens Bankshares* case. The chancery court emphasized that the *First Citizens Bankshares* dispute did not raise important and unresolved issues ("unprecedented claims") that might induce the Delaware courts to hear the case despite a non-Delaware exclusive forum provision. Providence v. First Citizens Bancshares, Inc., 99 A.3d 229, 240 (Del. Ch. 2014).

132. The classic article is Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. Rev. 1009 (1997). The term "moral arbiter" comes from David A. Skeel, Jr., *The Unanimity Norm in Delaware Corporate Law*, 83 Va. L. Rev. 127 (1997).

tions of liability in the most significant corporate law cases, but they also provide instruction on best practices for the directors of publicly held corporations.[133] In its ruling on a shareholder challenge to Disney's handling of its firing of a prominent executive, for instance, the chancery court chastised Disney CEO Michael Eisner for dominating the board and contrasted his behavior to acceptable board practices.[134]

Delaware's need to ensure it receives a steady stream of cases creates a tension for Delaware judges. As I noted earlier, the reputation of Delaware's judges is linked to Delaware's preeminence in corporate law.[135] The most obvious way to promote Delaware's interests is to establish generous rules for compensating attorneys without regularly imposing liability on managers and directors. But this approach creates the risk that the Delaware judges will appear to be participating in a form of implicit collusion. Providing a hospitable forum without inviting collusion would be tricky under any circumstances, but it is especially sensitive given the Delaware judges' role as moral arbiters in corporate law.

A decade ago, a law professor and a business school professor wrote an article that raised somewhat similar concerns.[136] They argued that after a freezeout merger[137] was announced, plaintiffs' lawyers would immediately sue, alleging that the directors had violated their fiduciary duties. Next, the directors representing the minority shareholders would negotiate a modestly higher merger price and, as part of their final agreement with the controlling shareholder, would propose to resolve the lawsuits filed by plaintiffs' attorneys and give the attorneys a hefty fee. The Delaware courts then routinely approved the fees. The authors concluded that "the chancery court's 100 percent approval rate clearly provides no support for claims that the court is acting as an effective monitor or is alert to the possibility of collusion."[138]

The article did not suggest that Delaware judges were deliberately permitting excessive fees, and the tendency to approve settlements with relatively limited scrutiny is not unique to Delaware. But the article raised eyebrows, and the freezeout cases continued to invite unseemly behavior, due in large part to the doctrinal context in which they arose. Because the controlling shareholder in a freezeout transaction has a conflict of interest, plaintiffs' attorneys could assert duty of loyalty claims, which are far more likely to succeed than duty of care

133. *See id.*

134. Although ultimately concluding that Eisner did not violate his duty to act in good faith, Chancellor Chandler stated that "Eisner's actions in connection with [Michael] Ovitz's hiring should not serve as a model for fellow executives and fiduciaries to follow. His lapses were many. To my mind, [his] actions fall far short of what shareholders expect and demand from those entrusted with a fiduciary position." *In re* the Walt Disney Co. Derivative Litig., 907 A.2d 693, 762–63 (Del. Ch. 2005).

135. *See supra* note 129.

136. Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law Mis(Shapes) Shareholder Class Actions*, 57 VAND. L. REV. 1797 (2004).

137. In a freezeout merger, the directors of a company that owns a controlling stake in the target corporation effect a merger that gives the minority shareholders cash for their shares in the target corporation, leaving the controlling company with 100 percent of the target corporation's stock.

138. Weiss & White, *supra* note 136, at 1845.

allegations.[139] As a result of the leverage this gave plaintiffs' attorneys, the parties allegedly developed their intricate freezeout dance, which led to generous fees for plaintiffs' attorneys and very little real benefit for the minority shareholders that the attorneys were ostensibly protecting.

In the *Cox Communications* case, Delaware's then-Vice Chancellor Leo Strine sharply criticized the pattern that had emerged in the freezeout cases.[140] "[P]laintiffs and defendants both have an incentive to settle nonmeritorious, premature suits attacking negotiable, going-private proposals," Strine wrote. "For their part, plaintiffs' lawyers can get sizable fees by 'contributing' to the successful work of a special committee and by settling at the same level that the special committee achieved."[141] Of the $4.95 million in attorney's fees requested by the plaintiffs' attorneys, Vice Chancellor Strine awarded only $1.275 million.[142] *Cox Communications* was one of several early 2000s decisions sounding an alarm on attorney's fees,[143] and it was part of an ultimately successful effort by the Delaware Chancery Court to reshape Delaware doctrine in the freezeout cases.[144]

Ironically, the Delaware courts' response to concerns about collusion may have created—or, at the least, contributed to—the rise of multi-forum litigation. Although there is considerable debate as to causes of the multi-forum trend, some commentators suspect that Delaware's newly tightened oversight of fees prompted plaintiffs' attorneys to consider other forums where courts might be more flexible about fees.[145]

Many of the cases that are filed outside of Delaware seem to be brought primarily for their holdup value.[146] Losing these cases might not be especially problematic for Delaware. But Delaware also risks losing significant cases—the cases that raise substantial issues and shape corporate law.

139. Controlling shareholders could avoid the rigorous freezeout scrutiny by conducting their freezeout transaction in two steps. The controlling shareholder would make a tender offer for the minority shares to increase its ownership stake to at least 90 percent. The controlling shareholder could then effect a short-form merger under section 253. Guhan Subramanian criticized the divergent treatment of the two freezeout techniques in an influential article that appears to have contributed to the doctrinal shift described in the text that follows. Guhan Subramanian, *Fixing Freeze-outs*, 115 Yale L.J. 2 (2005); *see also* Guhan Subramanian, *Post-*Siliconix *Freeze-Outs: Theory and Evidence*, 36 J. Legal Stud. 1 (2007) (finding that majority shareholders received significantly smaller premiums in two-step transactions).

140. *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604 (Del. Ch. 2005).

141. *Id.* at 605–06.

142. *Id.* at 648.

143. *See, e.g.*, Armour et al., *supra* note 9, at 644 (describing shift starting in 2001).

144. In *Cox Communications* and *In re CNX Gas Corp. Shareholders Litigation*, C.A. No. 5377-VCL. 2010 WL 2291842 (Del. Ch. May 25, 2010), the chancery court announced that it would provide business judgment review to both types of freezeout transactions if the transaction is negotiated by an effective special committee of the board of directors and conditioned on an affirmative vote of a majority-of-the-minority shareholders. The Delaware Supreme Court endorsed the unified standard in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

145. Armour et al., *supra* note 9, at 644.

146. *See, e.g.*, Friedlander, *supra* note 126; Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 Tex. L. Rev. 557 (2015).

If Delaware's courts had adopted Delaware-friendly interpretations of shareholder litigation clauses, the multi-forum litigation problem might have largely disappeared with no need for legislative intervention.[147] Indeed, a gradual restricting of loser-pays and non-Delaware exclusive forum clauses might have been better for Delaware in one very important respect: it might have diminished the risk that Delaware's hostility to these clauses—especially loser-pays provisions—would prompt at least a few corporations to reincorporate in states that permit the clauses, because gradual tightening would draw less attention to Delaware's hostility. But striking down these bylaws and charter provisions would raise questions about the credibility of Delaware judges. Even if the judge's self-interest played no role at all in her decision, critics might suspect that the judge's analysis was shaped by her own self-interest.[148]

Legislative intervention was an inspired alternative. The 2015 amendments were patently self-interested—as Delaware-regarding as judicial invalidation of loser-pays and non-Delaware forum bylaws would have been. But Delaware's obvious self-interest is less problematic for its legislature than for its courts.[149] Not only is Delaware's judiciary more central to its preeminence in corporate law, but state legislatures are expected to take state interests into account. Delaware's legislators are not the moral arbiters of corporate law; Delaware's judges play that role. By restricting shareholder litigation bylaws, Delaware lawmakers extracted the Delaware judiciary from an awkward predicament while also furthering Delaware's interest by ensuring that cases come to Delaware rather than elsewhere.

V. When Does the Delaware Legislature Intervene?

The success of Delaware's recent legislative intervention prompts one last question: when are Delaware lawmakers likely to redirect the course of corporate law? This question has received surprisingly little attention in the literature about Delaware's role in corporate law.[150] I begin by speculating why this is—why do scholars pay so much more attention to Delaware's judges than to its legislature?

147. The Delaware courts might have concluded, for instance, that loser-pays bylaws impermissibly insulate directors from judicial oversight by sharply reducing shareholders' ability to bring fiduciary duty litigation. They might have struck down most or all non-Delaware forum bylaws, reasoning that Delaware judicial oversight is part of the package of provisions that a corporation accepts when it incorporates in Delaware.

148. The dilemma is analogous in some respects to the position of an ostensibly independent director who has close, informal ties to the company she is overseeing. *See In re* Oracle Corp. Derivative Litig., 824 A.2d 917 (Del. Ch. 2003).

149. The Corporation Law Council's defense of the shareholder litigation amendments seems to reflect this intuition. In its effort to respond to criticisms that the legislation was "a protectionist act intended to enrich the members of the Council and their firms," the Council argued that "it is the General Assembly, not the courts, that should evaluate whether, on public policy grounds, the statute's authorizing breadth should be narrowed." Corporation Law Council, *supra* note 57, at 10.

150. The classic analyses of the Delaware legislature's role are Romano, *supra* note 61, and Macey & Miller, *supra* note 112. Neither focuses on legislative interventions that redirect Delaware corporate law. The seminal analysis of the most famous earlier intervention, the Delaware legislature's response to *Smith v. Van Gorkom*, is Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 Emory L.J. 1155 (1990).

I then try to discern rules of thumb about the Delaware legislature from its best-known interventions.

One possible reason for the dearth of attention to Delaware's legislature—or to the relationship between the courts and the legislature—is the unusually close links between the legislature and the courts.[151] Most proposed corporate law changes originate with the Corporation Law Council, a group of prominent corporate lawyers and law professors who have close ties with the legislature and with Delaware's judges.[152] Delaware lawmakers generally follow the Council's recommendations without making significant changes. Thus, it is easy to assume that the legislature's role is secondary.

A related reason for the apparent neglect is that headline interventions by the Delaware legislature are quite uncommon. Although the legislature amends Delaware law nearly every year, the vast majority of these changes are clarifications and minor adjustments. As noted earlier and discussed below, Delaware lawmakers rarely step in and dramatically redirect Delaware corporate law doctrine. Indeed, the Delaware Constitution discourages lawmakers from suddenly altering Delaware law by requiring that changes to Delaware corporate law be approved by a supermajority (two-thirds) vote.[153] This makes it difficult for lawmakers to secure controversial changes to Delaware corporate law.

What, then, are the exceptions? When *do* Delaware lawmakers shed their usual reticence and affirmatively redirect Delaware law?

The most famous legislative intervention of the past generation—the enactment of section 102(b)(7), which repudiated *Smith v. Van Gorkom*[154]—suggests one rule of thumb. After the Delaware Supreme Court held that the directors of Trans Union had violated their duty of care, despite obtaining a 40 percent premium for Trans Union's shareholders, the market for directors' and officers' insurance temporarily collapsed.[155] Subsequent Delaware Supreme Court cases probably would have reassured corporate directors that Delaware was not intending to dramatically toughen the duty of care and that *Van Gorkom* was an outlier. But the Delaware Supreme Court cannot act quickly or unilaterally; it has to wait for cases to come to it. The legislature was in a position to take action much more quickly, and this is precisely what the legislature did. Less than a year later, it enacted section 102(b)(7), which authorizes exculpation provisions that insulate directors from duty of care liability.[156] The *Van Gorkom* experience

151. Even Mark Roe, a particularly acute observer of Delaware institutions, treats Delaware's legislature and courts as more or less interchangeable. *See, e.g.*, Roe, *supra* note 80 (including both legislative and judicial changes as examples of Delaware's responsiveness to Congress and federal agencies); *see also* Macey & Miller, *supra* note 112, at 501–02 (describing influence of Delaware bar with the legislature and an "intricate web of personal and professional contacts" that link the bar and the judiciary).

152. A list of the twenty-two members of the Council can be found at http://www.dsba.org/sections-committees/sections-of-the-bar/corporation-law/.

153. Del. Const. art. IV, § 1.

154. 488 A.2d 858 (Del. 1985).

155. *See, e.g.*, Romano, *supra* note 150, at 1159–60 (describing *Van Gorkom* as one of the factors that precipitated a crisis in the D&O market).

156. Del. Code Ann. tit. 8, § 102(b)(7) (2015).

suggests that the legislature may intervene when an immediate correction is needed and the ordinary common law process is likely to be too slow.

The legislature's authorization of proxy access bylaws may also have been spurred by a need for haste. If the proxy access provisions were intended to preempt Congress and the SEC, Delaware needed to signal quickly that it understood the importance of proxy access. By early 2009, the legislative process that led to the Dodd-Frank Act was already underway. Not only was the process moving too quickly for Delaware to wait for an appropriate case to reach the Delaware Supreme Court, but it might well have taken even longer than usual for a case to emerge, given that the Delaware Supreme Court's disapproval of proxy access bylaws strongly discouraged shareholders from proposing them.

In addition to speed, legislative intervention offers a related benefit as well: it provides a clear, decisive signal that the rules have changed. To be sure, Delaware courts also can clearly signal a shift in doctrine, and on occasion they do.[157] But the common law decision-making process lends itself most naturally to a more subtle form of signaling. The Delaware Supreme Court's decision in the *Time-Warner* case was widely construed as a response to the growing perception that the takeover wave of the 1980s had gone too far,[158] and some suspect that the Delaware courts' handling of a high-profile case against the directors of Disney was influenced by public outrage at the corporate scandals of the early 2000s.[159] But in each instance, the court's gestures were understated (and with *Disney*, possibly imagined) and could easily be reconciled with Delaware corporate law doctrine. A dramatic shift after *Van Gorkom* or on proxy access would have been much more jarring. Far better for the Delaware legislature to respond instead.

Neither of the first two rules of thumb—the need for quick intervention or for a clear signal—seems nearly as relevant to the 2015 restrictions on shareholder litigation bylaws. It was not obvious either that Delaware needed to act immediately or that a decisive signal was necessary. Here, the legislature's intervention seems best explained as motivated by other factors, including judicial credibility. Indeed, even if concerns about judicial credibility did not directly influence the decision-making process, the preservation of credibility is a crucial effect of the legislative changes.

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157. The classic illustration is *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), which repudiated the "business purpose" requirement for freezeout mergers established by *Singer v. Magnavox* six years earlier.

158. Gordon, *supra* note 88, at 1971–75 (developing socio-historical account of *Time-Warner*).

159. A challenge by Delaware shareholders to the $140 million severance payment Disney paid to former executive Michael Ovitz led to procedural decisions (on the question of whether plaintiffs should be required to make "demand" on the directors) by the Delaware Supreme Court in 2000 and by the chancery court on remand in 2003. Some suspected that the outrage over corporate misbehavior by Enron and WorldCom in the early 2000s influenced the decision not to dismiss the case on procedural grounds (the plaintiffs' failure to make "demand" on the directors). By the time the case went to trial in 2005, the outrage had diminished. After a colorful trial, the chancery court rejected the shareholders' claims, and the Delaware Supreme Court affirmed. For a succinct summary of these developments, see William T. Allen, Reinier Kraakman & Guhan Subramanian, Commentaries and Cases on the Law of Business Organizations 356–58 (4th ed. 2012).

If I am correct about the importance of judicial credibility, this factor also may help to explain the dearth of dramatic Delaware legislative interventions in the past and to predict whether the legislature's recent penchant for stepping in will continue. Given the legislature's response to the proxy access and shareholder litigation controversies, Delaware might appear to have entered a new period of frequent legislative intervention. But this seems unlikely. If Delaware lawmakers regularly intervened, the interventions would both directly and indirectly undermine Delaware's courts: directly, because lawmakers are, in effect, chastising the court for its handling of the issue in question; indirectly, because regular intervention would suggest that the Delaware case law is provisional rather than authoritative. Indeed, the most important decision would be the least credible, because these would be the decisions most likely to be revised by the legislature.

Notice the delicate balance Delaware's legislature seems to have struck in 2015. When the legislature overrules Delaware's courts, the intervention is likely to undercut the credibility of the judiciary, because it reflects disapproval of a ruling or rulings. Yet with shareholder litigation bylaws and charter provisions, any short-term damage was considerably outweighed by the long-term benefits of removing the issues from the courts. Legislative intervention inoculated the judiciary against the risk that far more serious reputational harm might have occurred if the courts had continued to decide exclusive forum and loser-pays bylaw cases. But the strategy only works if the Delaware legislature uses it sparingly.

Perhaps there will be another dramatic intervention by the Delaware legislature in the next year or two. But the vulnerability of the Delaware judiciary's reputation, and its centrality to Delaware's corporate law eminence, suggest that Delaware lawmakers' interventions on proxy access and shareholder litigation bylaws are likely to be the last dramatic gestures we see from the legislature for a while.

Conclusion

Delaware is in an awkward position as the preeminent state of corporation. It is dominant yet vulnerable. Delaware's recent vulnerability stems from the realities that Congress can federalize key corporate issues at any time and that Delaware's success depends on a delicate compromise in which Delaware makes sure that plaintiffs' lawyers get paid while also giving significant protection for managers.

The genius of the Delaware legislature's dramatic interventions—first to permit proxy access bylaws and now to restrict shareholder litigation bylaws—is that while the interventions were nakedly self-protective, they may leave Delaware better off than it was before the start of the 2000s while also protecting the credibility of the Delaware courts. If there is a logical answer to the puzzle of Delaware's handling of the two recent bylaw controversies, I suspect this is where it lies.